United States Court of Appeals

for the Second Circuit

APPELLANT'S BRIEF

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Pls

75-4030

To be argued by
GEORGE ROWE, JR.

United States Court of Appeals
For the Second Circuit

Docket Number
75-4030

INTERNATIONAL FLAVORS & FRAGRANCES INC.,
Petitioner-Appellant,

against

COMMISSIONER OF INTERNAL REVENUE,
Respondent-Appellee.

ON APPEAL FROM THE UNITED STATES TAX COURT

BRIEF OF PETITIONER-APPELLANT

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Brief of Petitioner-Appellant

Preliminary Statement

This is an appeal from a decision of the Tax Court upholding an income tax deficiency of $73,715 asserted by the Commissioner of Internal Revenue ("the Commissioner") against the appellant herein, International Flavors & Fragrances Inc. ("IFF"), for the calendar year 1967. The Tax Court upheld the deficiency on the ground that IFF's gain upon the sale to Amsterdam Overseas Corporation ("Amsterdam") of a foreign exchange contract which IFF had entered into in 1966 with First National City Bank ("FNCB") was ordinary income. IFF had treated the gain as long-term capital gain. The case is reported at 62 T.C. 232 (1974).

This brief is submitted on behalf of IFF.*

Issues Presented

The issues presented upon this appeal are:

1. Did the Tax Court err in failing to hold that the contract between IFF and FNCB was a capital asset?

2. Did the Tax Court err in failing to hold that IFF realized long-term capital gain upon the sale of that contract to Amsterdam?

Statement of the Case

Jurisdiction is conferred upon this Court by Section 7482(a) of the Internal Revenue Code of 1954 (the "Code"), which provides:

> "The United States Courts of Appeals shall have exclusive jurisdiction to review the decisions of the Tax Court ... in the same manner and to the same extent as decisions of the district courts in civil actions without a jury...."

Under Rule 52(a) of the Federal Rules of Civil Procedure,

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* The following abbreviations of parts of the record have been used herein: "Decision" - Decision of the Tax Court; "Findings" - Findings of Fact of the Tax Court; "Opinion" - Opinion of the Tax Court; "Concurring Opinion" - Opinion by Judge Tannenwald, joined by Judges Goffe and Wiles; "Dissenting Opinion" - Opinion by Judge Hall, joined by Judges Forrester and Sterrett; "Stip." - Stipulation of Facts or Supplemental Stipulation of Facts; "Tr." - Transcript of Proceedings of April 30, 1973 or July 19, 1973. All page references to the foregoing parts of the record are to the pages of the Appendix ("App.").

findings of fact may be set aside if "clearly e. oneous, and due regard shall be given to the opportunity of the trial court to judge of the credibility of the witnesses". In applying the rule, an appellate court is not obliged to give weight to a trial court's findings of fact which are based upon documentary evidence. Orvis v. Higgins, 180 F.2d 537 (2d Cir. 1950); 5A Moore's Federal Practice ¶ 52.04 (2d ed. 1974).* That is the case with respect to practically all the findings here. This Court, of course, is free to make its own determinations of law. 5A Moore's Federal Practice ¶ 52.03(2).

The case concerns the proper tax treatment of a gain of $387,000 realized by IFF in the year 1967 upon IFF's sale to Amsterdam of a contract which IFF had entered into in 1966 with FNCB. In that contract, IFF sold to FNCB 1,100,000 pounds sterling at $2.7691 per pound, delivery and payment for such pounds to be made in 1968. The gain on the sale of the contract to Amsterdam was made possible

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* The Rule applies to facts in the record and to inferences therefrom, whether expressly designated as findings of fact or set forth in an opinion. Commissioner v. Duberstein, 363 U.S. 278, 291 (1960); Lamont v. Commissioner, 339 F.2d 377, 381 (2d Cir. 1964); Austin v. Commissioner, 298 F.2d 583, 585 (2d Cir. 1962); American Crystal Sugar Co. v. Cuban-American Sugar Co., 259 F.2d 524, 528 (2d Cir. 1958). A finding is clearly erroneous, even where there is evidence to support it, if "the reviewing court on the entire evidence is left with the definite and firm conviction that a mistake has been committed." United States v. United States Gypsum Co., 333 U.S. 364, 395 (1948).

by an intervening devaluation of the pound.

IFF claimed that the gain was long-term capital gain and so treated it on its tax return for the year 1967, whereas the Commissioner claimed that the gain was either short-term capital gain or ordinary income.

Prior to trial the parties stipulated as to certain facts. The case was tried before Judge William Quealey on April 30 and July 19, 1973. IFF presented the only witness at the trial, Mr. James F. Morrison, Controller of IFF. The report of the case indicates that it was "Reviewed by the Court."*

Judge Quealey wrote an opinion, with which apparently three or more other judges agreed; three judges concurred in the result but not in Judge Quealey's rationale of the case; three other judges dissented. Judge Quealey and those judges agreeing with his rationale of the case held that the gain was ordinary income. The concurring opinion held that it was short-term capital gain. The dissenting opinion held that it was long-term capital gain.

Statement of the Facts

IFF is a New York corporation with its principal

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* Section 7460 of the Code provides that the Chief Judge of the Tax Court may refer the decision of an individual judge to the whole Court. According to J. Edgar Murdock, former Chief Judge, Tax Court, such a referral may occur where the Chief Judge disagrees with the opinion of the individual judge, or the Chief Judge or the individual judge considers that the case presents an important question. Tax Court Procedure and Practice 197 (CCH, Inc. 1972).

place of business in New York, New York. It is engaged in the United States in creating and manufacturing flavor and fragrance products used by other manufacturers to impart or improve flavor or fragrance in a variety of consumer products. IFF owns stock in a number of foreign corporations, which engage in like business overseas, including International Flavours & Fragrances I.F.F. Great Britain Limited ("IFF (G.B.)"). (Findings, App. 86-87; Stip., App. 3; Tr., App. 43-44; Opinion, App. 97).

IFF publishes to its shareholders and the public consolidated financial statements in dollars only, in which its accounts, and those of its subsidiaries after translation of foreign currencies into dollars, are consolidated. IFF thus reflects for its stockholders and the public its investments and interests in its foreign subsidiaries. No other financial statements are published. (Findings, App. 87; Tr., App. 46; Ex. 24, 25, 26).

In 1966, IFF's officers were concerned about a possible devaluation of the British pound sterling, for such a devaluation would adversely affect IFF's investment and interest in IFF (G.B.), as reflected, in the year of such devaluation, in the translation of the English company's pound sterling accounts into dollars for purposes of IFF's consolidated financial statements. (Findings, App. 88; Ex. 27, App. 21-22; Opinion, App. 97). IFF, accordingly, entered

into a contract with FNCB under which IFF sold to FNCB 1,100,000 pounds sterling at $2.7691 per pound, delivery of such pounds and payment therefor to be made January 3, 1968. (Findings, App. 88; Ex. 3-C, App. 9-10; Ex. 27, App. 21-22; Opinion, App. 97). The number of pounds covered by the contract equalled the estimate of IFF's officers of the net pound sterling current assets of IFF (G.B.), the so-called "exposed assets," which would be translated at reduced values if the pound were devalued, plus an additional number of pounds to cover taxes on the gain which would occur if the contract were fulfilled by IFF. (Findings, App. 88; Ex. 27, App. 21-22; Ex. 23-W, App. 19; Tr., App. 67; Opinion, App. 97). The price of $2.7691 per pound was approximately 3/4 of 1% below the prevailing rate of exchange on December 29, 1966, the contract date. (Findings, App. 88-89; Stip., App. 5; Ex. 3-C, App. 9).

The pound, in fact, was devalued from the official rate of $2.80 to $2.40 on November 18, 1967. (Findings, App. 90). On December 20, 1967, about one month later, IFF entered into an agreement with Amsterdam, which read in pertinent part as follows:

> "Enclosed is the original of our agreement of December 29, 1966 with First National City Bank which we hereby sell to you today for $387,000. This sale is on the understanding that you will fulfill the obligation to deliver Sterling 1.1 million to First National City Bank on January 3, 1968 without recourse to us." (Findings, App. 90; Ex. 4-D, App. 11).

Amsterdam, at the prevailing rate of exchange at that time, could have fulfilled the contract at a profit to it, subject to any changes in that rate. (Ex. 3-C, App. 9-10; Ex. 4-D, App. 11; Stip., App. 5). On the other hand, it could have bought pounds at that time, as it turns out it did, and frozen its profit. (Findings, App. 91-92; Ex. 8-H, App. 15-16).

Argument

IFF claims that the Tax Court erred in not holding that IFF's contract with FNCB was a capital asset within Section 1221 of the Code, and in not holding that IFF realized long-term capital gain for tax purposes on the sale of the contract to Amsterdam under Section 1222(3) of the Code.

I

The Tax Court erred in failing to hold that the contract between IFF and FNCB was a capital asset.

Section 1221 of the Code defines a "capital asset" as

> "property held by the taxpayer (whether or not connected with his trade or business), but not includ[ing]
>
> (1) stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer . . ., or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business;

> (2) property, used in his trade or business, of a character which is subject to the allowance for depreciation . . ., or real property used in his trade or business;
>
> (3) [under some circumstances] a copyright, a literary, musical or artistic composition, a letter or memorandum, or similar property;
>
> (4) accounts or notes receivable acquired in the ordinary course of trade or business for services rendered or from the sale of property described in paragraph (1); or
>
> (5) [certain short-term interest-free government obligations issued at a discount]."

There is no question that IFF's contract with FNCB was property not included in any of the exceptions enumerated in the above subparagraphs. Indeed the Tax Court seems to have so conceded. (Opinion, App. 98-99). The contract was occasioned by concern that the British pound would be devalued. Its value depended upon whether the British pound was devalued before IFF had to deliver the pounds covered by the contract. A long line of authorities recognizes that such contracts can be capital assets. Meyer J. Stavisky, 34 T.C. 140 (1960), aff'd, 291 F.2d 48 (2d Cir. 1961); I.T. 3721, 1945 Cum. Bull. 164, modified, Rev. Rul. 57-29, 1957-1 Cum. Bull. 519 (contracts for the purchase or sale of securities on a "when issued" basis); Covington v. Commissioner, 120 F.2d 768, 770 (5th Cir. 1941), cert. denied, 315 U.S. 822 (1942); Modesto Dry Yard, Inc., 14 T.C. 374 (1950), acq.

1950-2 Cum. Bull. 3; G.C.M. 17322, XV-2 Cum. Bull. 151 (1936), replaced by Rev. Rul. 72-179, 1972-1 Cum. Bull. 57 (transactions in commodity futures). Indeed, both the Commissioner and the Tax Court recognized, in Frank C. LaGrange, 26 T.C. 191 (1956), that a contract for the sale of pounds sterling for future delivery -- the kind of contract at issue here -- qualified as a capital asset.

As stated, IFF's contract with FNCB literally qualified as a capital asset under Section 1221 of the Code. The Court, however, concluded that the transaction was "an ordinary income-related transaction" or a "loose 'hedge' against the risk of future losses of income" (Opinion, App. 103), and as such came within an exception to the statute enunciated by the Supreme Court in Corn Products Refining Co. v. Commissioner, 350 U.S. 46 (1955), rehearing denied, 350 U.S. 945 (1956).

In the Corn Products case, the taxpayer was a manufacturing company whose principal raw material was corn. The company, to protect itself against a shortage of or a rise in the price of corn, would regularly contract to buy corn for future delivery. If "spot" corn could thereafter be purchased advantageously, the company would purchase that corn and match that purchase with the sale of corn futures. Such purchases and sales were characterized as "hedging" transactions. The company sought to treat the

futures contracts as capital assets and to be taxed accordingly on their sale.

The Supreme Court held that such contracts were not capital assets in the hands of the company, finding that such contracts were so closely related to the principal raw material regularly used by the company in its manufacturing operations as to make their purchase and sale the equivalent of the purchase and sale of that raw material. The Court said that profits and losses arising from the purchase and sale of such contracts accordingly were profits and losses arising from the everyday operations of the business and should be considered as ordinary income or losses rather than capital gains or losses; that such a contract was so "integrally related" to the company's business that profits from the sale of such contracts should be considered a "normal source of business income."

(a) The Tax Court clearly erred in concluding that the contract with FNCB was an "ordinary income-related contract" or a "loose 'hedge' against the risk of future losses."

To bring the instant case within the coverage of the Corn Products case, the Tax Court, as we pointed out above, concluded that IFF's contract with FNCB was an "ordinary income-related transaction" or "a loose 'hedge' against the risk of future losses of income." (Opinion, App. 103).

Such conclusions, even if we assume arguendo that they would bring this case within the Corn Products case, are clearly erroneous. They arbitrarily assume relationships between the FNCB contract and IFF's income and impute motives to IFF which simply did not exist. They are not supported by findings of fact made by the Court; nor are they supported by other evidence in the record. They disregard and contradict undisputed evidence in the record establishing why IFF entered into the contract, and how it determined the number of pounds to be covered thereby. (Ex. 27, App. 21-22; Tr., App. 69-75).

As we set forth above under "Statement of Facts", IFF publishes consolidated financial statements in dollars, the accounts of IFF's foreign subsidiaries being translated into dollars for that purpose. IFF thus reflects its investments or interests in its foreign subsidiaries. Devaluation of the pound sterling would reduce certain of the accounts of IFF (G.B.) when so translated. The reductions naturally would carry through to the consolidated financial statements, both to the balance sheet and to the income statement, even though no transfers of cash or anything else would actually have taken place and even though no losses in the conventional sense would have actually been realized by IFF or its subsidiaries. IFF in 1966 feared a devaluation and, to

offset such an adverse effect, entered into the FNCB contract. The pounds covered by that contract were determined by the British company's "net current assets," its "exposed assets," the accounts comprising those assets being those which would be affected by devaluation. See Statement of Facts, supra; see also Tr., App. 66-67.

The evidence was mostly documentary, supplemented and explained by Mr. James Morrison, IFF's Controller, and it was uncontradicted.

The documentary evidence included a memorandum dated December 22, 1966 (one week prior to the FNCB contract) by H. G. Reid, Financial Vice President, to an officer of IFF (Holland), which showed that IFF's officers in 1966 were concerned about a possible devaluation of the pound, and contemplated entering into a contract for the future delivery of pounds, in order to offset a reduction in the dollar value of IFF (G.B.)'s accounts which would occur if the pound were to be devalued. (Ex. 27, App. 21-22; Tr., App. 52).

Mr. Reid's memorandum established how IFF had determined the number of pounds to be covered by the contract, i.e., 1,100,000 pounds. It stated that the company should protect "[IFF (G.B.)'s] exposed net current assets" since these will have to be written down in terms of dollars if there is a unilateral devaluation of the UK currency,"

and recommended that the amount of the transaction "be sufficient to equal, on an after-tax basis, the amount of the exposed net current assets . . . . [by means of a] contract to supply the sterling equivalent of U.S. $3,000,000 one year from now." The memorandum pointed out that "the after-tax protection will be 53% of this amount or approximately $1,600,000 which gives us reasonable protection of the approximately $1,500,000 of exposed net current assets of IFF-UK."

At an exchange rate of $2.80 per pound, $3,000,000 converts to about 1.1 million pounds, which is the number of pounds in the contract with FNCB.

The evidence, as stated, was uncontradicted. Indeed, the Tax Court at the outset of its opinion acknowledged that evidence as follows (App. 97):

> "[T]he petitioner became concerned that a devaluation of the English pound sterling would adversely affect, at least on paper, petitioner's investment in its second-tier subsidiary, IFF (G.B.), which was organized and operated in the United Kingdom. In an effort to protect against that risk, petitioner entered into a short sale contract with FNCB on December 29, 1966, whereby it sold 1.1 million British pounds sterling at the rate of $2.7691 per pound for delivery on January 3, 1968."

Nonetheless the Court apparently considered itself free to disregard the uncontradicted evidence as to why IFF entered into the contract, and how it determined the pounds

to be covered thereby.

Thus the Court's conclusions that the contract with FNCB was "an ordinary income-related transaction" or a "loose 'hedge' against the risk of future losses of income" (Opinion, App. 103) were made by the Court in the face of the evidence outlined above and were not predicated by the Court on any findings of fact made by it, nor on any other facts in the record, but rather upon a series of assertions in the Court's opinion which preceded those conclusions. Those assertions are set forth in the excerpt from the Court's opinion quoted below (App. 101-3):

> "In determining the effect of the short sale with respect to petitioner's business, this Court is not prepared to accept [Mr. Reid's] memorandum as controlling. Rather, we must look to the facts. Any diminution in value of the assets of IFF (G.B.) as measured in pounds sterling would be offset by a corresponding reduction in its liabilities, which likewise were payable in pounds sterling. The only loss that the petitioner could sustain was the loss on the conversion into U.S. dollars of the earnings and profits of its British affiliate and, secondly, the loss in U.S. dollars on account of its investment, if any, in the capital stock of such corporation. So long as IFF (G.B.) stayed in business, the latter would never be realized. All the petitioner really accomplished by the short sale of the pounds sterling was to recoup an amount equivalent to the ultimate losses in earnings which might be sustained when and if the pounds sterling earned by its British affiliate were remitted to the petitioner and converted into U.S. dollars.
>
> "In this case, the business of IFF (G.B.) was the business of the petitioner. The loss which the petitioner sought to offset by the short sale of pounds sterling was a loss to which its British affiliate was exposed in its everyday business.

> Purchases and sales of foreign currency, which in terms of the Internal Revenue Code must be considered as property other than money, for the purpose of offsetting losses which might result from fluctuations in the exchange rates, are part and parcel of a multinational business. If the petitioner had conducted its foreign business in the United Kingdom through a branch of the parent corporation rather than a British subsidiary, applicability of the Corn Products doctrine to such transaction in foreign exchange could hardly be questioned. The fact that a U.S. corporation conducts its foreign business through foreign subsidiaries rather than branches, does not necessarily warrant applicability of a different rule."

First, the Court stated that "In determining the effect of the short sale with respect to petitioner's business, this Court is not prepared to accept [Mr. Reid's] memorandum as controlling." If the Court meant that it was not accepting the memorandum because, while it may have established petitioner's purpose or intent in entering into the FNCB contract, that purpose or intent is immaterial in this case, then the Court misconstrues the Corn Products and related cases,* which clearly regard taxpayer's purpose or intent as critical to a determination of whether or not a contract like the one at bar is or is not a capital asset. Moreover, the Tax Court in this case obviously considered purpose or intent material elsewhere in its opinion, asserting

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* Steadman v. Commissioner, 424 F.2d 1 (6th Cir.), cert. denied, 400 U.S. 869 (1970); Booth Newspapers, Inc. v. United States, 303 F.2d 916, 921 (Ct. Cl. 1962); Wool Distributing Corp., 34 T.C. 323 (1960), acq. 1961-2 Cum. Bull. 5.

throughout that IFF sought to offset losses of future foreign-source income by means of the contract. (E.g., Opinion, App. 102-3). If, on the other hand, the Court meant by the statement that, in determining petitioner's purpose or intent, it was prepared to override the memorandum, then the Court clearly erred likewise, for the memorandum was properly authenticated, properly introduced in evidence, resolved important issues in the case and was completely uncontradicted, and should not have been overridden. (Tr. App. 49-52).

The Court then stated, apparently to show what would happen if the pound were devalued, and to pave the way for its own interpretation of the purpose of the contract, that a "diminution in value of the assets of IFF (G.B.) as measured in pounds sterling would be offset by a corresponding reduction in its liabilities, which likewise were payable in pounds sterling." The statement does not stand up on analysis. Assets and liabilities as measured in pounds do not change at all, of course, in the event of devaluation, except in terms of some other currency. When translated to dollars, they would not normally move in unison, as the Court assumed. Fixed and other non-current assets and non-current liabilities are translated at historical rates of exchange, so the British company's assets and liabilities would move in unison, as the Court assumed,

only if current assets equalled current liabilities, a condition which did not obtain here (Findings, App. 93; Ex. 23-W, App. 19) and, indeed, would be pure happenstance if it obtained anywhere.

The balance of the first paragraph of the excerpt quoted above is comprised of statements to the effect that the only loss IFF could suffer upon devaluation would be a loss upon conversion of the British company's earnings and profits to dollars and their remission to IFF, and that it was that possible loss that IFF offset by the contract with FNCB. Aside from the fact that the Court's assumptions are not based upon any finding of fact or other evidence in the record and are obviously open to question,* they imply a relationship between such a loss and the contract with FNCB which simply did not exist. The number of pounds covered by the contract, namely, 1,100,000 pounds, is unrelated to

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* For example, it is uncertain how devaluation would affect the dollar value of the earnings and profits of the British subsidiary. The purpose of devaluation is to improve the ability of the devaluing country's industries to compete for markets. It might well be that, over the long run, devaluation would increase the British company's earnings and profits, whether expressed in pounds or dollars. The British Chancellor of the Exchequer, James Callahan, stated at the time of the devaluation that:

> "[The] change in the value of the pound will, of course, have the effect that ... the things we sell abroad will become cheaper for people overseas to buy .... The advantage of devaluation is that it sharpens our competitive edge." New York Times, Nov. 21, 1967, at 75, cols. 2-3.

the earnings of the company for 1967, and it is unrelated to the earnings for any other period. It is unrelated to dividends or to any other contemplated intercompany transactions. Obviously it is not so related, for the number of pounds was determined by reference not to any of those things but to the net current or exposed assets of the British subsidiary, as the uncontradicted evidence established.

The second paragraph of the above excerpt from the Court's opinion forms no better a basis for the Court's conclusions.

It asserts that the business of the British company was the business of petitioner, whereas, for U.S. tax purposes, the businesses are considered separate and distinct. National Carbide Corp. v. Commissioner, 333 U.S. 422 (1949); Moline Properties v. Commissioner, 319 U.S. 436 (1943); PPG Industries, Inc., 55 T.C. 928 (1970); Columbian Rope Co., 42 T.C. 800 (1964), acq. 1965-1 Cum. Bull. 4; G.C.M. 4954, VII-2 Cum. Bull. 293 (1928).

It asserts that devaluation was an "everyday" risk, whereas it is common knowledge that the 1967 devaluation of the pound was considered an extraordinary event.

It implies that IFF regularly dealt in foreign currency, whereas there has been no such claim in this case and the record is to the contrary. (Findings, App. 86; Stip., App. 3; Tr., App. 72).

It states that Corn Products would apply to the transactions at issue if IFF had been doing business abroad through a branch, whereas, even if we were to so assume, there is no suggestion that IFF would have entered into the transactions in those circumstances.

It argues that the rule applied here should be the same, regardless of whether IFF does business abroad through a branch, or establishes a subsidiary to do so, whereas the Code itself normally makes a fundamental distinction between the two situations, and applies one set of rules in one case and another in the other. For example, if one does business abroad through a branch, the profits or losses of the branch, whether transmitted to the U.S. or not, are profits and losses of the U.S. company for U.S. tax purposes. On the other hand, if a U.S. company does business abroad through a subsidiary, the income or loss of the foreign subsidiary generally is not attributed to the parent for U.S. income tax purposes. A U.S. company may file a consolidated return with U.S. subsidiaries, and must incorporate the results of the operations of its branches abroad, but may not file a consolidated return with foreign subsidiaries. See Bittker & Eustice, Federal Income Taxation of Corporations and Shareholders ¶ 17.11, at 17-25 (1971). In the event of devaluation of a foreign currency, a reduction in a branch's dollar value occasioned thereby may be taken into account for tax purposes, but not

in the case of a subsidiary. Frederick Vietor & Achelis v. Salt's Textile Mfg. Co., 26 F.2d 249 (D. Conn. 1928); G.C.M. 4954, VII-2 Cum. Bull. 293 (1928).

A recent article comments on the majority opinion in this case as follows:

> "[T]he court endeavored to define IFF's exposure in terms of the Corn Products doctrine, by casting about for items of ordinary business income which IFF might receive. First it argued that IFF had hedged the dividend income which it might receive from its subsidiary. This was surprising because there was no evidence either that IFF was in fact concerned with future dividends or that a high proportion of its subsidiary's earnings was likely to be remitted.
>
> "Furthermore, the court defined IFF's exposure by collapsing the separate corporate form of parent and subsidiary, making exposure to the subsidiary exposure to the parent ....
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> * * * *
>
> "If the court intends that the corporate shareholder stand in place of the exposed corporation when it hedges and receive precisely the same tax treatment which the exposed corporation would have received on the hedge, it has created a significant and ill-advised departure from earlier cases which strictly separate shareholder from corporation for tax purposes." Costello, "Tax Consequences of Speculation and Hedging in Foreign Currency Futures," 28 Tax Lawyer 221, 245-46 (1975).

The case is squarely within Foran v. Commissioner, 165 F.2d 705 (5th Cir. 1948). In that case, the Tax Court had reached conclusions contrary to evidence produced at the trial by the taxpayer. The appellate court reversed the Tax Court, holding (id. at 707):

"Here there is direct and positive evidence from the witness who best knows, that this property was for eighteen months being held as an investment and not held for sale to customers. His testimony is consistent with every proven fact. He gives a credible reason why it was not for sale and why finally in 1941 he did sell it. We think the court's refusal to follow the sworn testimony is contrary to law, and requires the setting aside of its fact-finding as it would that of a jury.

* * * *

"We recognize that intent may be proved by circumstances, and that a party's testimony as to his intent may be rebutted by proof of circumstances which are inconsistent therewith. We hold that no circumstance found by the Tax Court here is inconsistent with the reasonable and uncontradicted testimony of Foran."

(b) The Corn Products case is not applicable to the facts of the instant case.

The Corn Products case is simply inapplicable to the facts of this case. Pounds sterling are not in any sense a raw material of IFF. IFF is not a dealer in foreign currency. The sale of its contract with FNCB to Amsterdam was not the equivalent of the sale of raw materials used in its business, namely, the manufacture of flavor and fragrance products. The profit from the sale of the contract to Amsterdam was not a profit arising from the everyday operations of IFF's business. The transaction was not so "integrally related" to IFF's business as to be considered a "normal source" of IFF's business income. There is no meaningful similarity between the IFF transaction and

those in the Corn Products case. The record shows that IFF's contract with FNCB was not only unrelated to IFF's raw material inventory, but also unrelated to any other source of business income to IFF. (Findings, App. 92-96; Tr., App. 69-75; Ex. 27, App. 21-22).

That the majority below pushed the Corn Products case far beyond its intended limits is made clear by cases which followed it.

In Philadelphia Quartz Co. v. United States, 374 F.2d 512 (Ct. Cl. 1967), the Court of Claims held that deposits required from the taxpayer's customers in order to insure the return of steel drums used for shipment of industrial chemicals, when forfeited to taxpayer, were taxable as capital gains and not ordinary income. The Court stated (id. at 515):

> "[T]he essence of the Corn Products decision is that transactions integral to or at the core of a business will occasion ordinary income treatment because of Congress' intention 'that profits and losses arising from the everyday operation of a business be considered as ordinary income or loss rather than capital gain or loss.'
>
> * * * *
>
> "The present facts are quite dissimilar. In no sense is the income from forfeited deposits integral to or at the core of plaintiff's chemical business in the fashion that the Corn Products Company's futures trading was intimately connected to its entire raw material supply operations."

IFF's contract with FNCB and its sale to Amsterdam were not transactions "integral to or at the core of" IFF's business. They are similarly not comparable to the transactions in corn futures in the Corn Products case.

In Deltide Fishing & Rental Tools, Inc. v. United States, 279 F. Supp. 661 (E.D. La. 1968), the taxpayer was engaged in the business of leasing special oil well tools. The Court held that amounts received by the taxpayer for tools which were lost or irreparably damaged by lessees were capital gain. It noted that in the Corn Products case the Supreme Court had stated that "profits and losses arising from the everyday operations of a business be considered as ordinary income or loss. . . ." The Court interpreted that statement as "stressing properly that activity of the business which normally directly produces business income." It stated (id. at 668-69):

> "Corn Products might well be distinguished from the present case in that property there (corn futures) was . . . essentially identical to the raw material which, in the course of the company's normal business operations, was converted into its 'saleable product,' and was for that reason an integral part of the revenue-producing process. The sale of the futures by taxpayer in the Corn Products case was not the sale of an investment, but the sale of what would, under ordinary circumstances, have been converted into the final saleable product; the revenue from the futures was the intended substitute for normal business income."

In KVP Sutherland Paper Co. v. United States,

344 F.2d 377 (Ct. Cl. 1965), KVP, a United States company with Canadian subsidiaries, used United States dollars to buy Canadian currency, which it then loaned to its Canadian subsidiaries against notes from those subsidiaries payable in Canadian currency. The Canadian subsidiaries repaid the notes. At the time the notes were repaid, Canadian currency had appreciated so that the fair market value of that currency in terms of dollars was higher than that value at the time the loans were made. The Government argued, citing the Corn Products case, that the notes were not capital assets in KVP's hands. KVP argued, and the Court agreed, that Corn Products did not apply, that the notes were capital assets, even though obviously related to KVP's investment in its foreign subsidiaries. See also United States v. Hess, 341 F.2d 444 (10th Cir. 1965); United States v. Rogers, 286 F.2d 277 (6th Cir.), cert. denied, 366 U.S. 951 (1961); Estate of John F. Shea, 57 T.C. 15 (1971).

(c) IFF is entitled to capital gains tax treatment even though another result would have obtained had IFF closed the contract rather than sold it.

As we have stated above, the Court clearly disregarded the record, made erroneous assumptions of fact and pushed the Corn Products case far beyond its intended limits. Although the Court did not so state, the Court may have felt that IFF should not be permitted to sell the FNCB contract

and thus realize a long-term capital gain, whereas if it had instead waited and fulfilled the contract, it would have been taxed at less favorable rates. The concluding statement of the Court's opinion so indicates (App. 103-4):

> "If petitioner in this case had closed out its short sale of British pounds in accordance with its contract with FNCB by purchasing pounds at the lower rate resulting from the devaluation, the resulting gain would have been taxable as ordinary income. * * * The fact that petitioner chose to sell the contract instead does not change the character of the transaction."

But the law is clear that IFF was entitled to choose a course of conduct which would minimize its taxes. A long line of cases so holds. Meyer J. Stavisky, 34 T.C. 140 (1960), aff'd, 291 F.2d 48 (2d Cir. 1961); Loewi & Co., 23 T.C. 486 (1954), acq. 1955-1 Cum. Bull, 5, aff'd, 232 F.2d 621 (7th Cir. 1956); Morris Shamis, 19 T.C. 641 (1953), acq. 1954-2 Cum. Bull. 5, aff'd per curiam, 213 F.2d 151 (3d Cir. 1954); Raymond B. Haynes, 17 T.C. 772 (1951), acq. 1952-1 Cum. Bull. 2; Conrad N. Hilton, 13 T.C. 623 (1949), acq. 1950-1 Cum. Bull. 3; Stanley D. Beard, 4 T.C. 756 (1945), acq. 1945 Cum. Bull. 1; W. F. Hobby, 2 T.C. 980 (1943), acq. 1944 Cum. Bull. 13; Clara M. Tulley Trust, 1 T.C. 611 (1943), acq. 1943 Cum. Bull. 23; John D. McKee, 35 B.T.A. 239 (1937), acq. sub nom Josephine C. Grant Trust, 1937-1 Cum. Bull. 10. All of such authorities stand for the proposition that sales of property for capital gain purposes will be respected even

though the seller would have encountered less favorable tax treatment if he had retained the property a short time longer. The opinion in this case is contrary to all those authorities.

As the Tax Court itself stated in the Beard case, supra, which involved a sale of preferred stock to American Cyanamid Company immediately prior to its redemption by a subsidiary of that company (4 T.C. at 757-58):

> "There is in the evidence no indication of sham on the taxpayer's part. He did not go through an empty form, like the setting up of a pseudo corporation * * * which the Commissioner is permitted to disregard, or a pseudo sale which was promptly rescinded, or which the revenue act warned might not be recognized. * * * He had an election as between two transactions, and bona fide he elected the one with less onerous tax consequences. He was not bound to retain his shares and await the redemption with its inevitably higher tax. He was permitted to sell them to Cyanamid or any other purchaser he could find. . . .
>
> "The Commissioner is . . . required to tax him in accordance with what occurred, and he is not permitted to distort the transaction by giving it an artificial character upon which a larger tax could be imposed if it were true. When the . . . redemption occurred, this taxpayer was not the owner of the shares; he had already sold them and realized his gain."

In the recent case of Daniel D. Palmer, 62 T.C 684, 693 (1974), the Tax Court stated: "There is no requirement that [the taxpayer] choose the more expensive way." Or as the Court stated in Ellis, Holyoke & Co., 29 T.C.M. 18, 32 (1970):

"It is a long established principle that so long as there is substance to the transactions, taxpayers may so arrange their affairs that their taxes may be as low as possible and that the tax consequences flow from what they have done rather than what they might have done. . . .

* * * *

"The fact that a transaction is arranged to favor some of the parties taxwise affords . . . no license to recast it into one of less advantage."

II

The Tax Court erred in failing to hold that IFF realized long-term capital gain upon the sale of the contract with FNCB to Amsterdam.

We argued above that the Tax Court erred on the facts and law, and should have held that the contract between IFF and FNCB was a capital asset.

(a) IFF, as a matter of fact and law, sold the FNCB contract to Amsterdam.

Section 1222(3) of the Code provides:

"The term 'long-term capital gain' means gain from the sale or exchange of a capital asset held for more than 6 months. . . ."

There is no question that IFF held the contract for more than six months. The only other question is whether the IFF-Amsterdam transaction constituted a "sale" within Section 1222(3) of the Code. If it did, IFF is entitled to have the gain on the sale taxed as long-term

capital gain. The majority opinion did not decide this issue as a matter of law, but its findings of fact include the following (App. 90):

> "On December 20, 1967, IFF (U.S.) entered into an agreement with Amsterdam Overseas Corp. (hereinafter referred to as Amsterdam), a large international banking institution located at 70 Pine Street, New York City. Neither IFF (U.S.) nor Amsterdam held stock in the other. The agreement, which was in letter form from IFF (U.S.) to Amsterdam and accepted by Amsterdam, read in pertinent part, as follows:
>
> > 'Enclosed is the original of our agreement of December 29, 1966 with First National City Bank which we hereby sell to you today for $387,000. This sale is on the understanding that you will fulfill the obligation to deliver Sterling 1.1 million to First National City Bank on January 3, 1968 without recourse to us.'"

IFF, in addition, showed that, at the rate of exchange in effect at the time IFF sold the FNCB contract to Amsterdam, Amsterdam stood to make a profit on the transaction. The evidence was uncontradicted that the contract between IFF and Amsterdam constituted an arm's length bargain between two independent companies. (Findings, App. 90; Ex. 4-D, App. p. 11). That Amsterdam, on the same date that it entered into the contract with IFF, chose to purchase pounds sterling from FNCB to cover its liability on the contract and thus fixed its profit on that date, rather than to wait to see if a change in the exchange rate would increase

its profit, does not affect the nature of the transaction between IFF and Amsterdam or the effect it should be given for tax purposes. (Findings, App. 8; Ex. 8-H, App. 15-16).

Accordingly, this Court should hold as a matter of law that IFF sold the FNCB contract to Amsterdam and that IFF is entitled to be taxed upon the gain it realized thereby at long-term capital gains rates. The dissenting opinion so held. As Judge Hall (with whom Judges Forrester and Sterrett agreed) said (Dissenting Opinion, App. 117-18):

> "Since the contract was a capital asset, concededly held for more than 6 months, long-term capital gain treatment was appropriate if the disposition of the contract on December 20, 1967, constituted a sale. . . . After the devaluation the contract right to sell pounds for more than their value was a valuable and readily marketable asset. No shenanigans or special deals were required to sell it, and we have no evidence either occurred. While the purchaser, Amsterdam, froze its profits by simultaneously hedging, there is no reason this circumstance should convert petitioner's sale into something else. Petitioner clearly divested itself of all title to, and realistic further concern regarding, the contract, and became unconditionally entitled to the price. No more is required for a 'sale', which has the same meaning in tax law as in ordinary parlance. Commissioner v. Brown, 380 U.S. 563 (1965); Helvering v. Flaccus Leather Co., 313 U.S. 247 (1941)."

(b) Contrary to the concurring opinion in this case, petitioner met its burden of proof as to whether there was a sale.

Judge Tannenwald, and two other judges, did not agree with either the majority opinion or the dissenting

opinion in this case, but concurred in the result reached by the majority on the ground that ". . . Amsterdam was in reality acting on behalf of petitioner in contracting to purchase pounds from the First National City Bank, that, in effect, such contract to purchase was used to close IFF's short position with First National City Bank . . ." and that IFF's profit on the sale to Amsterdam accordingly "represented short-term capital gain to IFF. . . ." (Concurring Opinion, App. pp. 106-7). Judge Tannenwald rests his opinion on his conclusion that Amsterdam, at or around the time it purchased IFF's contract with FNCB, purchased pounds sterling from FNCB to cover its liability on the IFF-FNCB contract, that IFF failed to prove that it did not participate in or know of Amsterdam's transaction with FNCB and that, accordingly, Amsterdam is to be considered, in effect, as IFF's agent. (Concurring Opinion, App. 109-10). First of all, IFF established that it had entered into an arm's-length contract, which contract, by its plain terms, constituted a sale of the FNCB contract to Amsterdam, without recourse to IFF (Ex. 4-D, App. 11). IFF thus met any reasonable burden of proof that should be placed upon it in this case. Neither the Commissioner nor the trial court indicated that IFF had to show that it did not participate in or know of Amsterdam's transaction with FNCB. The parties to the Amsterdam-FNCB contract were those two concerns; IFF was not

a party to that contract. IFF, incidentally, did present evidence that it did not participate in or know of that transaction, through Mr. Morrison, who testified, to clear up the trial judge's confusion as to the source of the documents comprising that transaction, that IFF did not have copies of those documents. (Tr., App. 53-54, 62). Moreover, even if we assume, contrary to the record and for purposes of argument, that IFF did participate in or know of that transaction, it does not follow that its sale of the FNCB contract to Amsterdam was thereby turned into an agency arrangement. As Judge Hall's dissenting opinion said (App. 118-19):

> "Petitioner's failure to prove its lack of knowledge of what Amsterdam planned to do with the contract is immaterial, for such knowledge could not add to or subtract from the finality of petitioner's disposition. The concurring opinion also refers to petitioner's failure to prove absence of 'participation' in the Amsterdam-City Bank arrangement, but the record is clear enough to support, indeed to require, the Court finding as a fact that the participants in that transaction were Amsterdam and First National City Bank. Moreover, petitioner could properly claim unfair surprise if taxed with the concurring opinion's theory that it failed to disprove that Amsterdam acted as petitioner's agent. Respondent's counsel, in his opening statement, admitted that 'IFF transferred its agreement with First National City Bank to Amsterdam Overseas Corporation for $387,000.' This admission, while in effect belatedly retracted by respondent's advancing a new theory at a second trial session, is quite inconsistent with any notion of IFF's subsequent retention of ownership. Accordingly, I would find that a sale took place and the gain was long-term capital gain. * * *"

Frank C. LaGrange, 26 T.C. 191 (1956), cited in the concurring opinion (App. 112), is clearly distinguishable from the instant case. In that case, LaGrange, in 1949, through his broker Carl M. Loeb, Rhoades & Co., pursuant to two contracts, sold 45,000 pounds sterling to two banking firms, delivery to take place in 1950. More than six months later, the pound having been devalued in the interim, LaGrange purported to sell the two contracts at a profit to the same broker, his own broker, Loeb, Rhoades.

The Court held that LaGrange, not Loeb, Rhoades, had closed the short sale, and had thereby realized a short-term capital gain rather than a long-term gain upon the sale of the contract, as the taxpayer claimed. The Court found that, in fact, Loeb, Rhoades was not acting as a principal, but only as LaGrange's agent, resting its conclusion on the fact that Loeb, Rhoades did not stand to profit from the purchase, did not charge a commission on the transaction, did not remit any funds to LaGrange until it had closed the contract and had full recourse to LaGrange for any loss it might sustain upon that closing. The Court stated (id. at 197):

> "The significant fact, which persuades us that the contract purchase transactions were not what petitioner contends, is that petitioner remained fully liable as the short seller until the sales were finally consummated and closed out by delivery of English pounds sterling to

> the purchasers. . . . Loeb, Rhoades made no profit on the purchase of petitioner's contracts, and it likewise could not have sustained one penny of loss because the risk remained petitioner's until the sales were consummated."

The LaGrange case is thus obviously distinguishable in fundamental respects from the instant case.

Conclusion

The decision below should be vacated and the case remanded to the Tax Court with instructions to enter a decision that there is no deficiency due from Petitioner-Appellant.

New York, New York
March 21, 1975.

Respectfully submitted,

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Of Counsel

IN THE UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

- -x

INTERNATIONAL FLAVORS & FRAGRANCES INC., :

Petitioner-Appellant, :

v. : No. 75-4030

COMMISSIONER OF INTERNAL REVENUE, :

Respondent-Appellee. :

- -x

CERTIFICATE OF SERVICE

I hereby certify that I have, on March 25, 1975, served corrected copies of the Brief of Petitioner-Appellant in the above action on Respondent-Appellee, by depositing two copies thereof in the United States mail, first-class postage prepaid, in an envelope addressed to its counsel at the following address:

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NOTICE OF ENTRY

Sir:- Please take notice that the within is a *(certified)* true copy of a
duly entered in the office of the clerk of the within named court on 19

Dated,

Yours, etc.,

FULTON, WALTER & DUNCOMBE

Attorneys for

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To

Attorney(s) for

NOTICE OF SETTLEMENT

Sir:—Please take notice that an order

of which the within is a true copy will be presented for settlement to the Hon.

one of the judges of the within named Court, at

on the day of 19

at M.

Dated,

Yours, etc.,

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Index No. 75-4030 Year 19

IN THE UNITED STATES COURT OF APPEALS
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INTERNATIONAL FLAVORS & FRAGRANCES INC.,

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To

Attorney(s) for

Service of a copy of the within

is hereby admitted.

Dated,

.....

Attorney(s) for

STATE OF NEW YORK, COUNTY OF ss.:

The undersigned, an attorney admitted to practice in the courts of New York State,

Check Applicable Box

☐ Certification By Attorney certifies that the within has been compared by the undersigned with the original and found to be a true and complete copy.

☐ Attorney's Affirmation shows: deponent is the attorney(s) of record for in the within action; deponent has read the foregoing and knows the contents thereof; the same is true to deponent's own knowledge, except as to the matters therein stated to be alleged on information and belief, and that as to those matters deponent believes it to be true. This verification is made by deponent and not by

The grounds of deponent's belief as to all matters not stated upon deponent's knowledge are as follows:

The undersigned affirms that the foregoing statements are true, under the penalties of perjury.

Dated:

.....
The name signed must be printed beneath

STATE OF NEW YORK, COUNTY OF ss.:

being duly sworn, deposes and says: deponent is

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☐ Individual Verification the in the within action; deponent has read the foregoing and knows the contents thereof; the same is true to deponent's own knowledge, except as to the matters therein stated to be alleged on information and belief, and as to those matters deponent believes it to be true.

☐ Corporate Verification the of a corporation, in the within action; deponent has read the foregoing and knows the contents thereof; and the same is true to deponent's own knowledge, except as to the matters therein stated to be alleged upon information and belief, and as to those matters deponent believes it to be true. This verification is made by deponent because is a corporation and deponent is an officer thereof.

The grounds of deponent's belief as to all matters not stated upon deponent's knowledge are as follows:

Sworn to before me on 19

.....
The name signed must be printed beneath

STATE OF NEW YORK, COUNTY OF ss.:

being duly sworn, deposes and says: deponent is not a party to the action, is over 18 years of age and resides at

Check Applicable Box

☐ Affidavit of Service By Mail On 19 deponent served the within upon attorney(s) for in this action, at the address designated by said attorney(s) for that purpose by depositing a true copy of same enclosed in a post-paid properly addressed wrapper, in — a post office — official depository under the exclusive care and custody of the United States Postal Service within the State of New York.

☐ Affidavit of Personal Service On 19 at deponent served the within upon the herein, by delivering a true copy thereof to h personally. Deponent knew the person so served to be the person mentioned and described in said papers as the therein.

Sworn to before me on 19

.....
The name signed must be printed beneath